No. 104

In the
Supreme Court of the United States
OCTOBER TERM, 1967

ALEXANDER TCHEREPNIN, et al.,
Petitioners,

vs.

JOSEPH E. KNIGHT, et al.,
Respondents.

MEMORANDUM FOR C. ORAN MENSIK, RESPONDENT

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OPINIONS BELOW

The opinion of the United States District Court has not been reported and is printed in the Transcript of Record herein at pages 29-33. The majority and dissenting opinions of the United States Court of Appeals for the Seventh Circuit are reported in 371 F.2d 374, and are printed of record herein at pages 43 and 53 respectively.

JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was entered on January 20, 1967. The petition for a writ of certiorari was filed April 20, 1967, and was

granted on June 5, 1967. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Did the Court of Appeals for the Seventh Circuit err in holding that a withdrawable capital share issued by a state-chartered Savings and Loan Association was *not* a "stock" within the definition of "security" contained in Section 3 (a)(10) of the Security Exchange Act of 1934, 15 U.S.C. 78c (a)(10)?

2. Did the Court of Appeals for the Seventh Circuit err in holding that withdrawable transferable shares in a mutual Savings and Loan Association are *not* securities within that definition, so that the anti-fraud provisions of that Act are not applicable to purchases and sales of such shares?

THE SECURITY AND EXCHANGE COMMISSION BY ITS OWN STATEMENTS CONSISTENTLY HAS RECOGNIZED WITHDRAWABLE CAPITAL ACCOUNTS NOT TO BE SECURITIES UNDER THE 1934 ACT.

The Security and Exchange Commission, since its creation by the Congress, has been subject to the limitations specifically set out in the 1934 Act and the amendments subsequently enacted. The SEC has consistently recognized its own limitations and down through the years both in public statements and in answer to inquiry by a member of City Savings Association (see appendix 1a) has stated:

> "In reply to your letter of September 25, 1953, Savings and Loan Associations are specifically exempt from the registration requirements under the various statutes administered by this Commission."

The Congress being cognizant of the special problems of the Savings and Loan industry, has on many occasions deemed it essential to review all phases of the 1934 Act and has held hearings regularly in its considerations of amendments and new laws in this particular and precise area of federal legislation. It is most significant that during such a hearing before the Subcommittee of the House Committee on Interstate and Foreign Commerce at the 1st session of the 88th Congress, the Chairman of the SEC, William L. Carey testified as follows:

> "With respect to savings and loan associations, an effort is made to treat them in essentially the same manner as insurance companies are treated, that is, mutual savings and loan associations will be exempt, just as mutual insurance companies are.
>
> "In the case of stock savings and loan associations, the stock, if purchased and traded as an equity investment, is subject to H.R. 6789 just as is stock of insurance companies.
>
> "On the other hand, savings accounts in savings and loan associations are not subject to the bill, just as insurance policies are not covered. Because of the fact that most savings and loan associations issue so-called shares, which in fact merely evidence the existence of a savings account, special provision had to be made in proposed section 12(g) (2) (C) of the bill to exempt that type of 'share.'"

It is to be noted that the SEC in its Special Study of the Security Markets (completed after the testimony of Chairman Carey (supra), which study was described as being industry-wide and most comprehensive, there was no treatment of withdrawable accounts, clearly indicating that the SEC itself did not consider such accounts to be "securities" within the ambit of its regulation or control.

The further fact that Congress itself has kept abreast of Savings and Loan institutional growth and its recognition of the constitutionally preserved role of all of the States in their constant and commendable regulation of such local institutions is apparent from the many hearings held by Congressional Committees implementing and affirming this important and necessary federal acknowledgment of the rights of the several States to supervise and control the corporations and associations to which they grant charters. Congress has made its legislative intent in this particular field quite clear by its exemption of State Savings and Loan Associations from the provisions of the Federal Bankruptcy Act and more recently in its enactment of the 1966 amendments to the Federal Savings and Loan Insurance Corporation Act. Such legislation clearly demonstrates the consideration given by the Congress to the unique problems of the Savings and Loan industry and specifically demonstrates the intent of Congress to limit federal regulation and control of such associations and gives recognition to the rights and function of all the several States in their control of local financial savings and loan institutions. Such acknowledgment of the role of the States has been constant and consistently expressed by the Congress in its enactments relating to the savings and loan industry.

In the instant cause the holding of the Court of Appeals for the Seventh Circuit that a withdrawable capital account in a savings and loan association chartered by the State of Illinois is *not* a "security" under the Security Exchange Act of 1934 is manifestly correct.

FEDERAL CONTROL OVER SAVINGS AND LOAN ASSOCIATIONS CANNOT BE PREEMPTED BY THE SECURITIES AND EXCHANGE COMMISSION.

The extent to which the Congress has recognized the constitutional and historical role of the several States in their desirable control and supervision over State chartered local institutions is manifest in the legislative history of all federal legislation bearing upon the savings and loan industry. Whenever federal supervision has appeared needed and deemed warranted by the Congress it has always been enacted with full recognition by the Congress that in this particular field all of the States possess retained constitutional powers that cannot be abridged. The Commissions created by Congress cannot preempt powers and authority with which they have not and/or cannot be vested. The Congress has seen fit to carefully preserve the relationship of State control *vis a vis* Federal regulation in avoidance of potential dangerous and unwarranted clashes of regulatory commissions with each other as well as the several States. The right of the States to control and regulate savings and loan institutions to which they issue charters is of course well settled. The industry-wide experience of savings and loan institutions has shown the Congress that each State does exercise such supervision and Congress has not seen fit to disturb or change this well established practice.

City Savings Association at no time utilized any brokers or agents in connection with the issuance, sale or transfer of the withdrawable "shares" here in question. It is undisputed in this record that this case does not present a factual situation involving such transfers or original issues by agents or brokers of any kind.

All States have regulatory agencies to supervise and control their State chartered savings institutions. City Savings Association was and is under such direct supervision and control in Illinois. The direct regulatory practice of all States includes the regular examination of such institutions and the frequency of such examinations and audits is well known to the Congress. There has been no demonstrated need for a duplication of federal agencies in this phase of the industry.

Congress has long recognized the exclusive powers of all the States to legislate in the field of criminal law and having foreseen the problems of duality in federal-state prosecutions for fraud has consistently deferred to the states in their regulation of State chartered savings and loan institutions.

The S.E.C. in its brief as *Amicus Curiae* refers to the complaint allegations by petitioners that City Savings Association in its solicitations through the mails made statements alleged to be false and misleading. Such complaint states *inter alia,* that the Association had been denied federal insurance and was controlled by a person previously convicted of mail fraud involving other savings and loan associations. It is to be noted that these allegations have no relevance on this appeal which is of course only concerned with the question certified by the District Court to the Court of Appeals for the seventh Circuit on interlocutory appeal.

It is the position of the individual respondents, as former management officials, that such allegations, whether concerned with so-called false advertising, unsafe financial policies or alleged failures to disclose, are not founded upon proof in this record and are specifically and directly denied. Such denial extends to alleged false ads and includes the fact that at no time did the

officers of this association in any way assert that this association had federal insurance (see appendix 2a and 3a). Their association practice was to answer inquiries directly and at no time stated that the association or its depositors were federally insured either by mail, direct advertising or in any manner. The association in its promotion of thrift adhered closely to accepted industry practices and its advertising contained no false or extravagant claims. The association was factually modern, liberal and progessive.

There is no evidence in this record of any failure to disclose any relevant information as would cause improper reliance by members of this mutual association in their purchase of capital shares or the opening of savings accounts. In point of fact, it would be improper for this Association to have commented or published any reference to the mail-fraud trial of its president because thoughout the time here pertinent, that case has been pending and is presently under consideration in an appellate court.

All of the States regulate and control the operation of the savings and loan institutions each charters and supervises them constantly throughout their existence.

The extent to which federal regulatory legislation of federal chartered savings and loan institutions deemed necessary by the Congress to parallel the regulation and control exercised by the States over state-chartered institutions has been clearly defined. In its 34th Annual Report (1966) to the Congress the Federal Home Loan Bank Board made the following statement:

> "The Federal Home Loan Bank Board was created by Congress almost 35 years ago to meet the urgent needs of the housing and mortgage markets at that

time. It provides aid and supervision for the thrift industry, and for the 12 District Banks serving it, in the following manner:

1. Under the Federal Home Loan Bank Act, to provide a credit reservoir for thrift and home-financing institutions through the Federal Home Loan Banks;

2. Under the Home Owners' Loan Act, to charter and supervise Federal savings and loan association; and

3. Under the National Housing Act, to direct the Federal Savings and Loan Insurance Corporation which provides insurance protection up to $15,000 for each savings account holder in insured institutions.

Thus the Board combines in one agency the three functions essential to regulation of a financial intermediary—chartering, insurance of accounts, and a central credit pool."

The clear statement of the Board itself is a reaffirmation of the intent of the Congress already expressed in its legislation which gives recognition to the limited extent that federal regulation is deemed needed and constitutionally proper, as well as approval to the strong role exercised by the States in their supervision of savings and loan institutions to which they issue charters. Any change in existing law must of course be made by the Congress and the holding by the Court of Appeals for the Seventh Circuit that a withdrawable account in a savings and loan association chartered by the State of Illinois is *not* a "security" within the definition of the 1934 Act so that the anti-fraud provisions of that Act are not applicable to purchases and sales of such account shares is correct.

For the foregoing reasons these respondents respectfully pray that the decision of the Court of Appeals be affirmed.

Respectfully submitted,

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